GOVERNMENT BUDGET AND THE ECONOMY

Introduction:-This is a descriptive chapter on government budget of Indian economy, wherein its objectives, importance, types, components, budget deficits and its types (Revenue, Fiscal, and Primary Deficit) and their implications are studied.

Government budget is an annual financial statement showing item wise estimates of expected revenue and anticipated expenditure during a fiscal year.

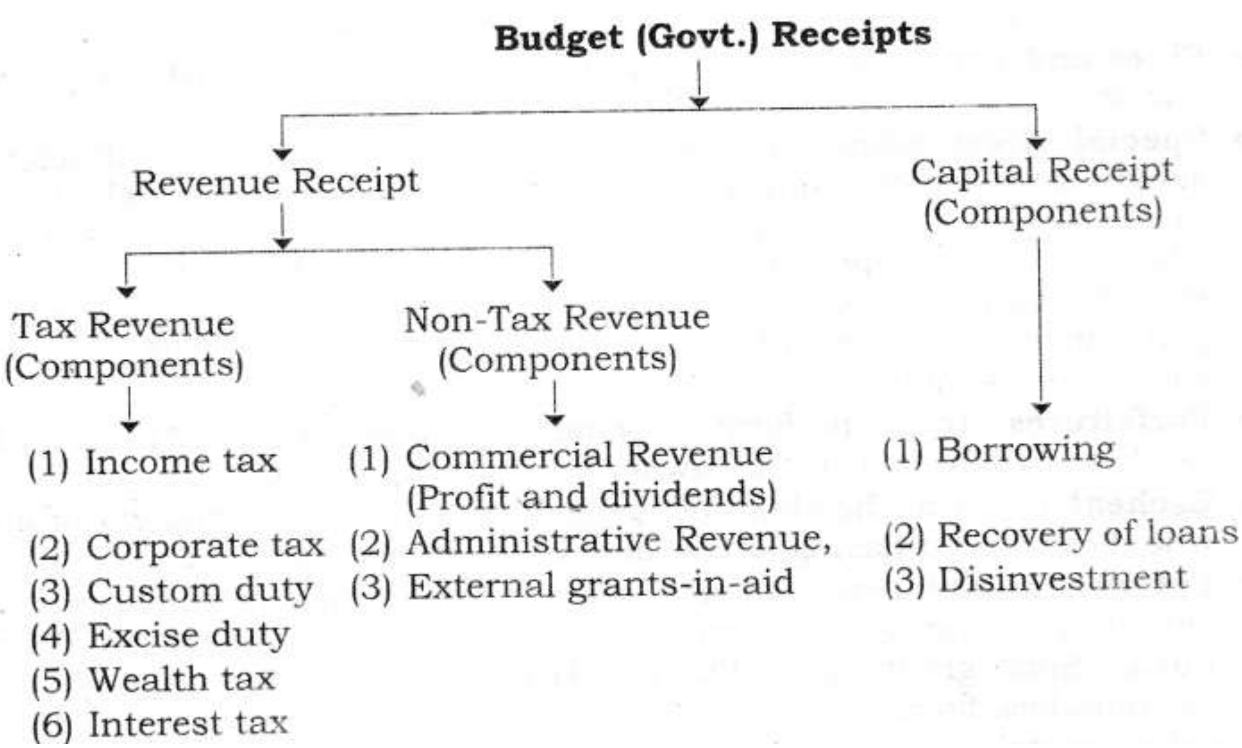
Components of a government budget: Government budget, comprises of two parts—
(a) Revenue Budget b) capital budget

Revenue Budget: Revenue Budget contains both types of the revenue receipts of the government, i.e., Tax revenue and Non tax revenue; and the Revenue expenditure.

Capital Budget: Capital budget contains capital receipts and capital expenditure, of the government.

Budget and its parts

Budget: A budget is a year-long financial report that explains how future revenue and expenditure will be calculated item-wise. The budget details a country's revenue and expenditures.
Parts of budget: a. Revenue Budget
b. capital Budget



a. Revenue Receipts

1. Meaning

- Government receipts:- Neither create any liabilities for the government and nor cause any reduction in assets of the government, are called revenue receipts.
  In revenue receipts both the conditions should be satisfied.
  Revenue receipts include items which are Repetitive and routine in nature.

2. Revenue receipts are further classified into

- **Tax Revenue**:- Tax revenue refers to receipts from all kinds of taxes such as income tax, corporate tax, excise duty etc.
  A tax is a legally compulsory payment imposed by the government on income and profit of persons and companies without reference to any benefit. Taxes are two types: Direct taxes and indirect taxes.

3. **Components of Non** –Tax Revenue:
   - Commercial Revenue (Profit and interest)
   - It is the revenue received by the government by selling the goods and services produced by the government agencies.
   - For example, profit of public sector undertakings like railways, BHEL , LIC etc
   - Government gives loan to state government, union territories, private enterprises and to general public and earns interest receipts from these loans.
   - It also includes interest and dividends on investments made by the government.

   Administrative revenue: The revenue that arises on account of the administrative function of the government.
   - **Fee**: - Fee refers to a payment made to the government for the services that it renders to the citizens. Such services are generally in public interest and fees are paid by those, who receive such services. for example, Passport fees, court fees, school fees in government schools
   - **License Fee:** License fee is a payment to grant a permission by a government authority. for example , registration fee for an automobile .
   - Fines and penalties for an infringement of a law, they are imposed on law breakers.
   - **Special Assessment: -** Sometimes government undertakes developmental activities by which value of nearby property appreciates which leads to increase in wealth, so it is the payment made by owners of those properties whose value has appreciated. For example, if value of a property near a metro station has increased, then a part of developmental expenditure made by government is recovered from owners of such property. This is the value of special assessment.
     Forfeitures are in the form of penalties imposed by courts that a person needs to pay in the court of law for failing to comply with court orders.
     Escheat refers to the claim of the government on the property of a person who dies without having any legal heir or without leaving a will.

♦ **External grants:** Government receives financial help in the form of grants, gifts from foreign governments and international organizations (IMF, World Bank). Such grants and gifts are received during national crisis such as earthquakes, flood, war etc.

Capital receipts:

(i) Meaning:

• Government receipts, that either creates liabilities (of payment of loan) or reduce assets (on disinvestment) are called capital receipts.
In capital receipts any one of the conditions must be satisfied.
• Capital receipts include items which are non-repetitive and non-routine in nature,

(ii) Components:

- **Borrowing (Domestic and External):** Borrowings are made to meet the financial requirement of the country. A government may borrow money:

Domestically: General Public (By issuing government bonds in the open market). Reserve Bank of India.
Externally: Rest of the world (foreign government and international institutions)

- **Recovery of Loans and Advances:** Loans offered to others are assets of the government. It includes recovery of loans granted by the central government to state and union territory governments. It is a capital receipt because it reduces financial assets of the government. For example, The Government of India may give Rs. 1000 crore as a loan to The Government of Delhi. Here the value of asset is Rs. 1000 crore. When The Government of Delhi repaid Rs. 100 crore, the value of The Government of India assets reduces to Rs. 900 crore. Since, recovery of loan reduces the value of assets, it is termed as a capital receipts.
- **Disinvestment:** A government raises funds from disinvestment also. Disinvestment means selling whole or a part of the shares (i.e., equity) of selected public sector enterprises held by government. As a result, government assets are reduced.

Capital Expenditure: Capital expenditures are one-time investments of money or capital made by a government for the aim of expanding in various sectors and businesses in order to create profits. These funds are typically used to acquire fixed assets or assets with a longer lifespan. These include machinery, manufacturing equipment, and infrastructure-improvement equipment. These assets provide value to the government during their entire lifespan and may or may not have a salvage value.

Balanced, Surplus and Deficit Budget

Balance budget: A balanced budget is a condition in financial planning or the budgeting procedure where the total revenues are equivalent to or greater than the total expenditure. A budget can be considered[1] as balanced in experience after a complete year's account of revenues and expenses have been recorded. A company's budget for the upcoming year can be called balanced based on anticipations or approximate values.
surplus budget:- A surplus budget is a condition when incomes or receipts overreach costs or outlays (expenditures). A surplus budget normally refers to the financial conditions of the governments. However, individuals choose to use the term 'savings' rather than 'budget surplus.' Surplus is a manifestation that the government is being effectively operated and regulated.
Deficit Budget: A deficit budget is said to have occurred when expenses exceeds the revenue and it is a symptom of financial health. The government normally uses this term to its spending instead of entities or individuals. Accrued government deficits form the national debt.

Government expenditure:- Economic trends can influence the growth or shrinkage of fiscal deficits in several ways. Increased levels of economic activity generally lead to higher tax revenues, while government expenditures often increase during economic downturns because of higher outlays for social insurance programs such as unemployment benefits. Changes in tax rates, tax enforcement policies, levels of social benefits, and other government policy decisions can also have major effects on public debt. For some countries
Measures of government deficit

Fiscal Policy: Keynesian economics, a theory developed by economist John Maynard Keynes, serves as the foundation for fiscal policy. It is the system by which a government makes changes to its planned expenditure and tax rates in order to monitor and influence the performance of a country's economy. It is implemented in tandem with monetary policy, by which the central bank of the country impacts the country's money supply. This policy influence aids in containing inflation, increasing employment, and, most significantly, maintaining a healthy currency value.

Primary Deficit: It is derived by subtracting interest payments from the fiscal deficit.

Primary deficit = Fiscal deficit – Interest payments on previous loans

Implications of Primary Deficit:

- It reflects how much of the government's borrowings will be used to cover costs other than interest payments.

Measures to Correct Different Deficits:

- Government subsidy cuts will aid in reducing the deficit.
- Where assets are not being used efficiently, disinvestment should be carried out.
- Increased emphasis on tax-based revenues, as well as necessary steps to prevent tax evasion.
- Borrowing from both domestic and international sources.
- A broader tax base could also aid in the reduction of the government's deficit.

Revenue deficit = Total revenue expenditure – Total revenue receipts

Implications of Revenue Deficit are:

- A significant revenue shortfall indicates budgetary indiscipline.
- It indicates that the government is dissaving, i.e., the government is utilizing savings from other sectors of the economy to pay its consumer expenditure.
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- It demonstrates the government's excessive expenditures on administration.
- It lowers the government's assets owing to disinvestment.
- A significant revenue deficit sends a warning signal to the government to either cut spending or boost revenue.

Debt: A quantity of the money borrowed by one entity, the borrower, from another entity, the lenders, is referred to as debt. Governments borrow money to cover their deficits, which allows them to fund regular operations as well as large capital expenditures. This debt might be in the form of a loan or bond issuance.

Perspectives on the Appropriate Amount of Government Debt: There are two interlinked aspects of the issue. One is whether government debt is a burden and two, the issue of financing the debt. The burden of debt must be discussed keeping in mind that what is true of one small trader's debt may not be true for the government's debt, and one must deal with the 'whole' differently from the 'part'. Unlike any one trader, the government can raise resources through taxation and printing money.

Other Perspectives on Deficits and Debt: One of the main criticisms of deficits is that they are inflationary. This is because when government increases spending or cuts taxes, aggregate demand increases. Firms may not be able to produce higher quantities that are being demanded at the ongoing prices. Prices will, therefore, have to rise. However, if there are unutilised resources, output is held back by lack of demand. A high fiscal deficit is accompanied by higher demand and greater output and, therefore, need not be inflationary.

Deficit Reduction: Government deficit can be reduced by an increase in taxes or reduction in expenditure. In India, the government has been trying to increase tax revenue with greater reliance on direct taxes (indirect taxes are regressive in nature – they impact all income groups equally). There has also been an attempt to raise receipts through the sale of shares in PSUs.

The FRBM Act, 2003 sets a target for the government to establish financial discipline in the economy, reduce fiscal deficit and improve the management of public funds. The Act sets target for the government to bring down fiscal deficit.

Main Features

1. The Act mandates the central government to take appropriate measures to reduce fiscal deficit to not more than 3 percent of GDP and to eliminate the revenue deficit by March 31, 20098 and thereafter build up adequate revenue surplus

2. It requires the reduction in fiscal deficit by 0.3 per cent of GDP each year and the revenue deficit by 0.5 per cent. If this is not achieved through tax revenues, the necessary adjustment has to come from a reduction in expenditure.

3. The actual deficits may exceed the targets specified only on grounds of national security or natural calamity or such other exceptional grounds as the central government may specify.

4. The central government shall not borrow from the Reserve Bank of India except by way of advances to meet temporary excess of cash disbursements over cash receipts.

5. The Reserve Bank of India must not subscribe to the primary issues of central government securities from the year 2006-07.

6. Measures to be taken to ensure greater transparency in fiscal operations